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TAGS: ECPS ETRD FR
SUBJECT: France Telecom's Transformational Strategy

Not for Internet distribution

Summary

¶1. (SBU) On March 30, France Telecom (FT) executives told us that FT had to expand into new areas, both geographically and functionally, since telecom services were minimally profitable in France. FT emphasized that value-added services delivered through broadband and mobile telephony would be the most profitable businesses in developed countries, while developing countries had greater yields in mobile telephony. On services, FT has developed a new "triple play" offering, combining telephony with broadband Internet and television, under its well-known mobile telephone "Orange" brand. FT is building out its fiber network to offer high value services, such as video on demand. Geographically, FT is putting more emphasis on growing its cellular business in higher-yielding emerging markets, such as Eastern Europe, Africa, and China. However, FT pointed out that that new European Commission recommendations forcing providers to share cutting-edge broadband infrastructure with rivals would slow down incumbents' investment in very high-speed internet by diminishing rates and profit margins. End Summary.

¶2. (U) On March 30, France Telecom Senior Executive Vice President Louis-Pierre Wenes in charge of FT's transformation and French operations, and International Business Development Executive Vice President Anne Bouverot told econoffs that FT had to expand into new areas, both geographically and functionally. Wenes noted that telephone penetration growth rate in the EU and U.S. was less than one percent. Telecom services were minimally profitable in France. Market participants were providing minimal service in a bid to lower costs on razor-thin profits and gain market share. While such a situation should drive consolidation between incumbent EU operators, member state politicians would not allow national champions to fall into foreign hands. (Note: This conversation took place before the press reported on AT&T and America Movil's bid for Telecom Italia. End note.)

FT's Broadband Plan

¶3. (U) Wenes said that FT has a huge data base of current and former customers, and the firm seeks to leverage that information by offering new content. FT is targeting more than 12 million clients for broadband fixed-line connections by 2008, including more than 8 million subscribers for its Livebox "triple play" offer. With the Livebox, FT offers broadband internet access at 100 Mbps with Wi-Fi

capability, unlimited telephone calls to fixed lines within France through Voice over Internet Protocol (VoIP), and a range of digital television channels. FT expects more than 12 million customers by 2008 for broadband mobile services (including third-generation services), with 6 million customers in France, another 5 million in the UK, and another million elsewhere. FT is hoping to gain more than one million subscribers for MaLigne TV in France, its offering for television via the internet, with more than 400 million euros (USD 483 million) in revenue from direct paid content. As of year-end 2006, FT was serving 5.9 million ADSL Orange customers in France for an estimated 49 percent share of the French broadband market.

Internet Access: Margins Squeezed
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4 (SBU) According to Wenes, French consumers are very interested in broadband triple play - and they enjoy the most advanced and competitive ADSL-based triple-play market in Western Europe. FT had changed the branding of its internet offering from Wanadoo to Orange to capitalize on its better known mobile telephone brand name. But Wenes wondered whether Orange would be able to make money on its triple-play offering, given that strong competition had pushed prices down and limited revenue growth. Inexpensive "triple play" services, which average 30 euros a month, have helped push broadband adoption to more than 75 percent of all French Internet users - the highest in Western Europe.

Fiber to the Home in Paris

¶5. (U) FT has only recently stepped up its deployment of fiber to the home (FTTH). By allowing other operators to access its fiber network, FT hopes to avoid the regulatory problems that have plagued

Deutsche Telekom AG (which requested a regulatory holiday on providing access to its fiber networks to recoup its investment costs). Wenes confirmed that FT's early FTTH deployment phase would run from 2007 to 2008 in many cities, including Paris, Lyon, Marseille, Poitiers and Toulouse, with the aim of having 150,000 to 200,000 customers connected by the end of 2008 out of a potential client base of one million. Orange will be offering internet access with symmetrical speeds of up to 100 megabits/second, several high-definition TV channels, and unlimited calls. He believes that within five years, French consumers would use this network to choose their own programs with the video on demand such bandwidth would allow. According to Wenes, fourth generation mobile networks (4G) would cover the parts of France that fiber would not be able to reach. He believed that 4G had more potential in France than either WiMAX or Wi-Fi.

¶6. (SBU) Wenes and Bouverot argued that the current battle between Deutsche Telekom and the EU Commission over access to fiber networks does not bode well for investment in high-speed networks. FT agrees with Deutsche Telekom's policy of exclusive access to help it recoup costs by selling new services, including internet protocol television (IPTV). At the same time, FT is aware that the idea of a "regulatory holiday" is "doomed" since the European Commission has threatened the German government with legal action over Deutsche Telekom's stance.

¶7. (SBU) Wenes and Bouverot believe it is unwise of the European Commission to require former state-run monopolies to form separate companies to manage their service business and access to their infrastructure. This would make investment unviable, particularly since the new investment was in fiber networks and not the old copper network. The more the European Commission squeezed incumbents' profits through overzealous regulation, the less money they would invest in fiber networks and the slower the roll-out of new infrastructure and associated services. Furthermore, they say, the European Commission proposals go in the opposite direction of U.S. policy, which encourages investment by removing obligations on telephone operators to share fiber networks with rivals for a period of time.

Cellular Operations in Emerging Markets

¶8. (U) FT, in addition to offering new services, wants to expand its businesses in markets with higher growth rates and yields. It already has significant market share in various wireless markets, including the United Kingdom, Poland, Spain, Belgium, Egypt, Romania, Slovakia, and Moldavia. Wenes expects that FT's wireless operations in mature markets such as the U.K., Spain, and France to continue to expand with the introduction of new higher-margin 3G services. However, he stressed that the real driver of cellular growth over the next few years would come from the company's international assets in the fast-growing, emerging markets of Eastern Europe and Africa.

¶9. (U) FT reported that its Eastern European subscriber base grew some 23 percent between 2005 and 2006, while Africa, the Middle East and other emerging markets recorded a 51 percent increase in customers. As a result, the company's cellular operations in nations such Poland, Slovakia, and Romania posted double-digit gains in revenue, a trend that is likely to continue for the foreseeable future. Since growth was so much faster in these emerging markets, FT was not seeking to acquire any mobile telephony firms in the U.S. or EU.

Looking to China

¶10. (U) Orange is looking to invest in Asia in general and in China in particular. The firm entered into a long-term Strategic Partnership with China in 2004 to cooperate in the research and development of technologies and applications, exchanging personnel and training Chinese staff. Last year, FT was the first foreign telecoms carrier to join the TD-SCDMA Forum, an industry group promoting China's homegrown standard for 3G mobile wireless services.

¶11. (SBU) Wenes said that becoming a profitable player in the Chinese market was extremely difficult, but the market was "too big to ignore." He noted that just five years ago, Chinese telephone equipment manufacturers were too saturated with domestic orders to respond to international orders in a timely way, and the equipment

did not use the latest technology. Now, however, the Chinese were responding very rapidly, and their technology was among the best available. Leading manufacturers could afford to staff their research laboratories with approximately 10,000 staff.

¶12. (SBU) Wenes wondered how Western firms could compete with companies from a country that has three times as many people working in research and development as FT. Western firms would have to consolidate and focus on certain technologies and products, and develop niche markets. He predicted that as the automobile industry faces difficulties today, telecom equipment manufacturers would face difficulties in the future. He predicted that each technology niche would have two to three manufacturers, and no more than four to five would operate in each line of production. On the service side, he expected European incumbent operators would merge as soon as politically viable.

Comment

¶13. (SBU) Broadband growth in France, although more robust than elsewhere, has come at a price -- that of very poor customer service. There are some 20,000 pending law suits against the major operators for shoddy practices and poor service. That number could rise very quickly as operators cut customer service costs to lower prices and gain market share. FT believes customer service will be the next battleground, and it is poised to win.

Stapleton